TP adjustment is to be made only in respect of purchases made from AE and not from unrelated parties

Summary – The Bangalore ITAT in a recent case of Kirloskar Toyoda Textile Machinery (P.) Ltd., (the Assessee) held that TP adjustment is to be made only in respect of purchases made from AE and not from unrelated parties

Facts

- The assessee-company was engaged in business of manufacture and sale of textile machinery, related parts, automotive parts and trading material, handling equipments and related parts.
- TPO found that there were two international transactions. (a) auto component segments and (b) textile machinery segment. In auto component segments, the TPO held arithmetic mean margin of the comparables at 9.70 per cent on sales against 8.08 per cent of assessee. Thus, PLI of the comparables fell within the margin of (+-) 5 per cent.
- With regard to the textile segment, the TPO determined the mean margin of the comparables at 13.32 per cent against 6.15% of assessee and computed the ALP.
- The assessee filed an application under section 154 and pointed out that the TPO had erred in computing the margin of comparables at 13.32 per cent. The actual mean margin in terms of percentage was 8.26 per cent. TPO had admitted the arithmetic error committed by him in calculating the determination of ALP and worked the T.P. adjustment accordingly.
- DRP confirmed TPO's order.
- On appeal, the assessee contended that the TPO failed to give benefit of section 92C(2) and that the adjustment ought to have been confined to the value of transactions the assessee had entered with its AEs but TPO included the Purchaser made from unrelated parties.

Held

- The Assessing Officer has worked out the Arm's Length cost of operating revenue by reducing the total revenue with Arm's Length mean margin which was worked out at 8.26 per cent. In other words, the total sales have been reduced by this percentage in order to achieve the cost. This cost was further reduced by the purchases with unrelated parties and thereafter the TPO computed the ALP of the purchases made by the assessee from the AE. This total exercise is erroneous because there is no element of undue benefit which would be presumed to have been extended by the assessee on the purchases from the third parties. The basic anomaly in this formula would be that it could make multi-fold adjustments, for example if the assessee had made purchase of only Rs. 2 crores from the AE and Rs. 91 crores from unrelated parties, the adjustment worked out by the TPO in the figure would be more than the total purchases made from the AE.

- Taking into the consideration the above factors, the submission made by the assessee was to be accepted and the Assessing Officer was directed to confine the adjustment, *qua* the purchases made by the assessee from the AE. To be more specific, the adjustment is to be made only to purchases made from AE. However, this exercise is be carried out after verifying the details of purchases available. The Assessing Officer first determine the purchase of raw material and components from the AE and then determine the ALP having regard to the mean profit margin of comparable cases at 8.26 per cent.
- As far as the another submission is concerned, this issue is remitted to the file of the Assessing Officer for re-adjudication. The Assessing Officer, after determination of any adjustment, if required to the value of the international transactions shall determine, whether the assessee is entitled for the benefit of proviso appended to section 92C(2). Since the TPO granted this benefit to the assessee with regard to the automotive component segment, it cannot be denied *qua*, this claim if the adjustment falls within the range provided in the proviso.